

✓



LAW OFFICE  
JUN 19 1967

REPORT TO  
THE CONGRESS OF THE UNITED STATES

B 3992

June 19/67

NEED FOR COMPLIANCE  
WITH THE  
"TRUTH-IN-NEGOTIATIONS" ACT OF 1962  
IN AWARD OF CONSTRUCTION CONTRACTS

DEPARTMENT OF DEFENSE



BY  
THE COMPTROLLER GENERAL  
OF THE UNITED STATES

JUNE 1967

087494 6/19/67 770224

**REPORT TO**  
**THE CONGRESS OF THE UNITED STATES**

**NEED FOR COMPLIANCE**  
**WITH THE**  
**“TRUTH-IN-NEGOTIATIONS” ACT OF 1962**  
**IN AWARE) OF CONSTRUCTION CONTRACTS**

---

**DEPARTMENT OF DEFENSE**



**BY**  
**THE COMPTROLLER GENERAL**  
**OF THE UNITED STATES**

**JUNE 1967**



COMPTROLLER GENERAL OF THE UNITED STATES  
WASHINGTON O C 20548

B- 39995

June 19, 1967

To the President of the Senate and the  
Speaker of the House of Representatives

This is the third report in 1967 by the General Accounting Office informing the Congress of various specific steps that need to be taken in the Department of Defense to fulfill the purposes of Public Law 87-653, the "Truth-in-Negotiations" Act of 1962. This report concerns our review of 237 construction contract actions, each involving over \$100,000, negotiated since November 1964 for a total of about \$128 million.

We found a need for the construction agencies--the Army Corps of Engineers and the Naval Facilities Engineering Command--to improve compliance with the cost or pricing data requirements of Public Law 87-653 and the implementing Armed Services Procurement Regulation in negotiating construction contracts and modifications,

We found generally that, in the negotiation of prices of construction contracts and modifications, (1) sufficient cost or pricing data supporting the contractors' proposals, as required by the law, were not obtained, (2) cost analyses of contractors' proposals to determine that the prices were fair and reasonable, as required by the regulation, were not made, and (3) related prescribed procedures for utilizing advisory audits were not followed.

Instead, the construction agencies placed primary reliance on comparisons of the contractors' proposals with their own cost estimates as a means of evaluating the reasonableness of prices,

A primary reason for the construction agencies' not complying with Public Law 87-653 and the Armed Services Procurement Regulation appeared to be their belief that the law (and regulation) was not applicable to construction contracts since contractors' proposals were evaluated on the basis of comparisons with Government estimates.

Comparing a proposal with an estimate serves a useful purpose, but such comparison is not an acceptable substitute for obtaining and

B- 39995

analyzing **current** and complete cost or pricing data of the contractor as required by law and regulation.

Illustrations of the above deficiencies are contained in the exhibit to the report which describes selected negotiated contract actions that we reviewed.

We brought these findings to the attention of the **secretary** of Defense and proposed that he emphasize to the Departments of the Army and Navy the need for improvement of the construction agencies' compliance with the requirements of Public Law 87-653 in the negotiation of construction contracts 2nd modifications.

The Deputy Assistant Secretary of Defense (Procurement) in letters dated February 1 and March 9, 1967, agreed in substance with our **proposals.**

**Copies of this report** are being sent to the Director, Bureau of the Budget; the Secretary of Defense; and the Secretaries of the Army and Navy,

A handwritten signature in black ink, appearing to read "James B. Axtell". The signature is written in a cursive style with a large initial "J".

Comptroller General  
of the United States

## C o n t e n t s

	<u>Page</u>
INTRODUCTION	1
BACKGROUND	4
FINDING	6
Need for improving compliance with cost or pricing data requirements of Public Law 87-653 and implementing regulations in the negotiation of construction contracts and modifications	6
Cost or pricing data obtained from contractors generally insufficient and impaired effectiveness of certification	7
Cost analyses of price proposals generally not made	12
Undue reliance placed on Government estimates in negotiating prices	15
Noncompliance with cost or pricing data requirements not reported in internal audit coverage	17
Conclusions	18
Agency comments	19
SCOPE OF EXAMINATION	21
	<u>Appendix</u>
APPENDIXES	
Principal officials of the Department of Defense and the Departments of the Army and Navy responsible for administration of activities discussed in this report	I 24
Letter dated February 1, 1967, from the Deputy Assistant Secretary of Defense (Procurement) to the General Accounting Office	II 26
Letter dated March 9, 1967, from the Deputy Assistant Secretary of Defense (Procurement) to the General Accounting Office	III 28
EXHIBIT	
Examples of awards negotiated without obtaining and analyzing sufficient cost or pricing data supporting contractors' proposals	30

REPORT ON NEED FOR COMPLIANCE  
WITH THE  
"TRUTH-IN-NEGOTIATIONS" ACT OF 1962  
IN AWARD OF CONSTRUCTION CONTRACTS  
DEPARTMENT OF DEFENSE

INTRODUCTION

The General Accounting Office has made an examination into the practices of the Army Corps of Engineers and the Naval Facilities Engineering Command (NavFac) in the negotiation of military construction contracts and modifications over \$100,000 awarded during the period November 1964 through June 1966 under the requirements of Public Law 87-653 and the implementing Armed Services Procurement Regulation (ASPR).

Our review was directed primarily toward an examination into the extent to which the respective procurement officials, in the negotiation of construction contracts and modifications over \$100,000, were obtaining from the contractors, and were analyzing, factual and verifiable cost or pricing data and certificates as prescribed by the ASPR which implemented Public Law 87-653. Our examination was made pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53); the Accounting and Auditing Act of 1950 (31 U.S.C. 67); and the authority of the Comptroller General to examine contractors' records, as set forth in 10 U.S.C. 2313(b).

During our review, we visited seven Corps offices and five NavFac offices in the continental United States and several overseas offices of each service and examined contract files and related records for negotiated contracts and contract modifications totaling about \$128 million. We did not review records of actual costs incurred under the contracts nor did we examine into

architect-engineer contract actions. The scope of our examination is described in detail on page 21 of this report.

On January 16 and February 15, 1967, respectively, we submitted to the Congress our reports on "Need for Improving Administration of the Cost or Pricing Data Requirements of Public Law 87-653 in the Award of Prime Contracts and Subcontracts" and "Survey of Reviews by the Defense Contract Audit Agency of Contractors' Price Proposals Subject to Public Law 87-653," each designated B-39995.

In the report dated January 16, 1967, we advised the Congress of the results of our examination into the extent to which Department of Defense procurement officials responsible for awarding negotiated contracts were requiring contractors to comply with the cost or pricing data requirements of the ASPR implementing Public Law 87-653. We concluded that there was a need for improving such compliance. That examination, however, did not include a review of military construction contracts but dealt primarily with development and supply contracts.

Construction procurements were selected for separate review and reporting because of the unique aspects of such procurements and the special contracting procedures involved, as set forth in section XVIII of the ASPR. One such procedure involves the preparation of an independent Government estimate for each proposed contract or modification expected to exceed \$10,000, the comparison of that estimate with the contractor's proposal, and the resolution of any significant differences. This process appeared in many instances to be the only cost or pricing analysis performed by the Corps and the NavFac in evaluating contractors' proposals and negotiating prices.

The Corps and the NavFac, which have been designated by the Congress as the construction agents for the Department of Defense,

award the **bulk** of defense construction contracts. Although the Air Force does award some construction contracts, its activities in that regard are minor in relation to those of the construction agencies.

The principal officials *of* the Department of Defense and the Departments of the Army and Navy responsible for administration of activities discussed in this report are listed in appendix I.

## BACKGROUND

In recognition of the need to provide the Government with safeguards against inflated cost estimates by contractors in military procurements where competition is lacking, the Congress enacted Public Law 87-653, in September 1962, which added section 2306(f) to the Armed Services Procurement Act (Title 10, United States Code). The law provides that a prime contractor or a subcontractor shall be required to submit cost or pricing data under the circumstances listed below and shall be required to certify that, to the best of its knowledge and belief, the cost or pricing data that it submitted **were** accurate, complete, and current:

"(1) Prior to the award of any negotiated prime contract under this title where the price is expected to exceed \$100,000;

"(2) Prior to the pricing of any contract change or modification for which the price adjustment is expected to exceed \$100,000, or such lesser amount as may be prescribed by the head of the agency;

"(3) Prior to the award of a subcontract at any tier, where the prime contractor and each higher tier subcontractor have been required to furnish such a certificate, if the price of such subcontract is expected to exceed \$100,000; or

"(4) Prior to the pricing of any contract change or modification to a subcontract covered by (3) above, for which the price adjustment is expected to exceed \$100,000, or such lesser amount as may be prescribed by the head of the agency."

The law also provides that the above contracts and subcontracts shall contain a provision--often referred to as defective-pricing-data clause--for adjustment of increased prices resulting from the

contractor's submission of data that are not accurate, complete, or current, as follows:

"Any prime contract or change or modification thereto under which such certificate is required shall contain a provision that the price to the Government, including profit or fee, shall be adjusted to exclude any significant sums by which it may be determined by the head of the agency that such price was increased because the contractor or any subcontractor required to furnish such a certificate, furnished cost or pricing data which, as of a date agreed upon between the parties (which date shall be as close to the date of agreement on the negotiated price as is practicable), was inaccurate, incomplete, or noncurrent \*\*\*."

Exceptions to the above requirements of Public Law 87-653 are stated therein as follows:

"\*\*\* the requirements of this subsection need not be applied to contracts or subcontracts where the price negotiated is based on adequate price competition, established catalog or market prices of commercial items sold in substantial quantities to the general public, prices set by law or regulation or, in exceptional cases where the head of the agency determines that the requirements of this subsection may be waived and states in writing his reasons for such determination."

The Department of Defense has provided for the implementation of Public Law 87-653 in ASPR 3-807.

## FINDING

### NEED FOR IMPROVING COMPLIANCE WITH COST OR PRICING DATA REQUIREMENTS OF PUBLIC LAW 87-653 AND IMPLEMENTING REGULATIONS IN THE NEGOTIATION OF CONSTRUCTION CONTRACTS AND MODIFICATIONS

In our opinion, there is a need for the Army Corps of Engineers and the Naval Facilities Engineering Command to improve compliance with the cost or pricing data requirements of Public Law 87-653 and **ASPR** in the negotiation of construction contracts and modifications,

We found that prices for construction contracts and modifications had been negotiated without sufficient cost or pricing data having been obtained from the contractors and without adequate cost analyses of the contractors' cost estimates having been made to determine that the prices were fair and reasonable. Related prescribed **procedures for utilizing advisory audits were usually not followed**. We believe that the Corps and the NavFac placed undue reliance on their own cost estimates as a means of evaluating prices proposed by contractors. Examples of these findings are presented in the exhibit.

In addition to the above, we found that the internal audit organizations of the Army and Navy had not reported on the noncompliance with the cost or pricing data requirements of Public Law 87-653 in the negotiation of construction contracts and modifications,

Cost or pricing data obtained from contractors generally insufficient and impaired effectiveness of certification

We found that generally the cost or pricing data obtained from the contractors in support of price proposals were insufficient to meet the intent of Public Law 87-653 and the requirements of ASPR. The certificates from contractors to the effect that the cost or pricing data submitted were accurate, complete, and current often could not be related to specific identified data; therefore, the effectiveness of the certifications was impaired. Likewise, although the contracts and modifications usually contained defective-pricing-data clauses, the unavailability of identifiable supporting cost or pricing data would make it almost impossible to determine what price adjustments, if any, might be recoverable by the Government because of inaccurate, incomplete, or noncurrent data submitted by the contractors,

In implementation of Public Law 87-653, ASPR 3-807.3 provides with certain exceptions that, prior to the award of negotiated contracts and contract modifications expected to exceed \$100,900, the contracting officer shall require the contractor (1) to submit, in writing, cost or pricing data in support of proposed costs and (2) to certify that to the best of its knowledge and belief, the cost or pricing data submitted are accurate, complete, and current,

In ASPR 3-807.3(e), the requirement for submission of cost or pricing data is defined as follows:

"'Cost or pricing data' as used in this Part refers to that portion of the contractor's submission which is factual. The requirement for 'cost or pricing data' subject to certification is satisfied when all facts reasonably available to the contractor up to the time of agreement on price and which might reasonably be expected to affect the price negotiations are accurately disclosed to

the contracting officer or his representative. The definition of cost or pricing data embraces more than historical accounting data; it also includes, where applicable, such factors as vendor quotations, nonrecurring costs, changes in production methods and production or procurement volume, unit cost trends such as those associated with labor efficiency, and make-or-buy decisions or any other management decisions which could reasonably be expected to have a significant bearing on costs under the proposed contract. In short, cost or pricing data consist of all facts which can reasonably be expected to contribute to sound estimates of future costs as well as to the validity of costs already incurred. Cost or pricing data, being factual, is that type of information which can be verified. Because the contractor's certificate pertains to 'cost or pricing data,' it does not make representations as to the accuracy of the contractor's judgment as to the estimated portion of future costs or projections. It does, however, apply to the data upon which the contractor's judgment is based. This distinction between fact and judgment should be clearly understood."

ASPR 3-807.3(a) authorizes exceptions to the requirement for contractor cost or pricing data in negotiated procurements expected to exceed \$100,000 where it has been determined that the price negotiated is based on (1) adequate price competition, (2) established catalog or market prices of commercial items sold in substantial quantities to the general public, or (3) prices set by law or regulation., ASPR 3-811 requires that under these circumstances the contracting officer include in the record of negotiation a statement of the basis for such determination.

We found that, in 50 of 237 contract actions reviewed, cost or pricing data had been considered by the contracting officers not to be required pursuant to one of the above authorized exceptions. In 46 of the 50 cases, adequate price competition was cited as the authority for the exception.

In our examination of these 50 awards, we found that the statements required under ASPR 3-811 often had not been made a matter of record in the contract file. At the Corps' Okinawa District Office, 12 contracts (of 12 reviewed) and five modifications (of seven reviewed) were stated to have been based on price competition. However, none of the contract files reviewed contained a statement of the basis for this determination. Records of the Corps' Far East District Office, Seoul, Korea, showed that eight contracts (of nine reviewed) had been based on price competition, but none of the files contained the required statement giving the basis. In several of the overseas construction procurements considered to be competitive, the contractors chosen appeared to have had a definite advantage over other offerors as a result of being mobilized at the construction sites when new projects were offered,

The cost or pricing data provisions of Public Law 87-653 and ASPR were clearly applicable to the remaining 187 contract actions--140 were negotiated by the Corps and 47 were negotiated by the NavFac.

For many of the contracts and modifications reviewed at the Corps, we found, however, that, although the Corps had obtained the required certificate as to the submission of accurate, current, and complete cost or pricing data, the data furnished by the contractor to the contracting officer consisted of little more than a breakdown of the proposed price showing the major elements of estimated cost. In other cases there was little or no evidence in the Corps' files as to what cost or pricing data had been made available to the Government negotiators prior to the awards or had been covered by the certification.

For example, at the Corps' Canaveral District Office, Merritt Island, Florida, our examination of data furnished by the contractors in support of 16 modifications exceeding \$100,000 each and totaling \$13,031,078 showed that less than 2 percent of this amount had been supported by information identified in a manner permitting verification. We found that in none of the 23 contract actions reviewed at the Corps' Fort Worth District Office, Fort Worth, Texas, were the contractors required to submit cost or pricing data identified in a manner which would permit verification of the price proposal to the supporting data.

Furthermore, we found many cases where the scope of the work negotiated was not the same as that for which the contractor had submitted its proposal and the data certified had not been revised.

For example, at the Corps' Ballistic Missile Construction Office, Norton Air Force Base, California, for 46 contract modifications covered by contractors' cost certifications, the total amount proposed by the contractors was \$46 million, whereas the total negotiated amount was \$30 million. The supporting memorandums of negotiation in many of these 46 modifications stated that the scope of the work negotiated was not the same as that for which the contractor had submitted its proposal. The district office did not require the contractors to submit revised proposals to cover the exact scope of work negotiated. In our opinion, such certificates were not effective because they did not relate to costs proposed for the work that was awarded,

In summary, in 108 of the 140 Corps contract actions to which the cost or pricing data provisions applied, we found that such cost or pricing data had not been submitted or were inadequate for cost analysis.

In 13 of the 47 NavFac contract actions reviewed, a certificate that the cost or pricing data submitted were current, complete, and accurate was not obtained, apparently because of oversight on the part of division officials. Certificates were obtained on the remaining contract actions. We found, however, that in none of the 47 cases had the contractor submitted complete verifiable cost or pricing data in support of its proposal.

We believe that, to the extent that cost or pricing data are not obtained, the effectiveness of the procedure requiring a certificate is impaired. Furthermore, when the data certified are not identified and/or when the scope is changed after submission of the data and revised cost or pricing data are not submitted in support thereof, the Government's right under the defective-pricing-data clause may be impaired. Under such circumstances, it may be impracticable for the contracting officer to establish whether the data actually used by the contractor in support of the cost estimate were in fact defective in the light of other data which were available and known to the contractor at that point in time.

Cost analyses of price proposals  
generally not made

In addition to finding that cost or pricing data obtained in writing from the contractors were generally inadequate to meet the intent of Public Law 87-653 and the requirements of ASPR, we found that cost analyses of the contractors' proposals, required by ASPR, were generally not made. Also, the related prescribed procedure for utilizing advisory audit services was usually not followed. Instead, reliance for obtaining reasonable prices was generally placed on price analyses comparing the contractors' proposals with Government estimates.

ASPR 3-807.2 requires that a cost analysis be performed in connection with any negotiated contract or modification expected to exceed \$100,000, for which cost or pricing data were required to be submitted. The ASPR states that the extent of the cost analysis should be that necessary to ensure reasonableness of the pricing result, taking into consideration the amount of the proposed contract and the cost and time needed to accumulate the necessary data for analysis. The ASPR states also that, where the determination of reasonableness of a proposed price has been developed through cost analysis, price analysis may be useful in corroborating the overall reasonableness of a proposed price and that price analysis techniques should be used to support or supplement cost analysis wherever appropriate.

As defined in ASPR 3-807.2, price analysis is the process of examining and evaluating a prospective price without evaluation of the separate cost elements and proposed profit of the individual prospective supplier whose price is being evaluated. One such technique employs a comparison of proposed prices with estimates of

cost independently developed by personnel of the purchasing activity.

Cost analysis, as defined in ASPR 3-807.2, is the review and evaluation of a contractor's cost or pricing data and of the judgmental factors applied in projections of the data to the estimated costs, in order to form an opinion on the degree to which the contractor's proposed costs represent what performance of the contract should cost, assuming reasonable economy and efficiency. It includes the appropriate verification of cost data, the evaluation of specific elements of cost, and the projection of these data to determine the effect on prices of such factors as: (1) the necessity for certain costs, (2) the reasonableness of amounts estimated for the necessary costs, (3) allowances for contingencies, (4) the basis used for allocation of overhead costs, and (5) the appropriateness of allocations of particular overhead costs to the proposed contract,

In addition, ASPR 3-809 provides that the contracting officer shall request an audit review by the contract audit activity prior to the negotiation of a contract or modification resulting from a proposal in excess of \$100,000 where the price will be based on cost or pricing data submitted by the contractor pursuant to ASPR 3-807.3.

Our review showed that, instead of making cost analyses, the Corps and the NavFac essentially performed price analyses consisting of comparisons of the contractors' proposals with independent Government estimates and resolutions of any significant differences. The existence of Government estimates was also used as a reason for not making audits of the proposals.

As discussed on pages 10 and 11, cost or pricing data submitted by the contractors were inadequate for 108 Corps contract actions and for 47 NavFac contract actions, or a total of 155 contract actions. Advisory audits were performed for only 21 of these contract actions. For the remaining 134 contract actions, advisory audits were not requested and there was very little evidence of cost analyses. Illustrations of instances where no cost analyses were performed are presented in the exhibit.

ASPR 3-809 provides that the requirement for audit of proposals may be waived by the contracting officer whenever it is clear that the information already available is adequate for the proposed procurement and that, in such case, the contract file shall be documented to reflect the reason for any such waiver. We found that such documentation was not included in some cases where the advisory audits had been waived. Furthermore, in cases where the contract files were so documented, the reason given for waiving the audits of the contractors' proposals was the existence of the Government estimates.

ASPR indicates, however, that audit of proposals should be waived only when it is clear that information already available is adequate for the proposed procurement. Since a cost analysis is always required (see ASPR 3-807.2) when cost or pricing data are required to be submitted, it follows that the information referred to by the ASPR as a basis for waiving the audit would include that information normally obtained from a cost analysis of the proposal,

Undue reliance placed on Government estimates  
in negotiating prices

As discussed above, we found generally that cost analyses of contractors' proposals, required by ASPR, and audits of proposals, where required by ASPR, were not made and that reviews of the cost or pricing data submitted by the contractors were limited to comparisons with Government estimates. In this connection, we believe that the Corps and the NavFac placed undue reliance on comparisons of the independent estimates with the contractors' proposals as a means of negotiating contract prices.

ASPR 18-108.1 requires that for construction procurement an independent Government estimate of construction cost, in as great detail as if the Government were competing for the award, be prepared for each proposed contract and modification thereto affecting price, anticipated to cost \$10,900 or more.

For negotiated construction procurement, ASPR 18-305.1 requires that, after preparation of the Government estimate, the proposals and cost or pricing data submitted by potential contractors be evaluated, analyzed, and compared with the Government estimate and that, where there are significant differences between the Government estimate and the proposals submitted on any item, the contractors be requested to submit cost or pricing data concerning such elements as wage rates or fringe benefits and significant materials and equipment allowances, which data also shall be evaluated and analyzed.

We found that Corps negotiating personnel had operated on the premise that the procedures for comparing the contractor's proposal with an independent Government estimate and limiting the negotiated price to the Government estimate were their primary assurance of a

reasonable price. We noted, however, that, when the proposal was greater than the Government estimate, the Government estimate was often raised--on the basis of information obtained during negotiations--to equal or exceed the price negotiated.

At the Corps Ballistic Missile Construction Office, Norton Air Force Base, California, we were informed that the Government estimator, after preparing his independent estimate, compared the contractor's proposal, item by item, with his estimate, and resolved any major differences between the two. However, our examination of the contract and modification files disclosed no record that differences had been reconciled or identified as required by the ASPR.

At the Corps New York District Office, New York, N.Y., we found that, for two of the three negotiated modifications reviewed, the Government estimators had substantially increased their estimates as a result of information given them during the course of contract negotiations with the contractors.

With regard to NavFac's procedure for evaluating the reasonableness of contractors' proposals by comparing them with independent Government estimates, we found that in eight awards independent Government estimates were not prepared or the Government estimates consisted of computations made on the basis of data from the contractors' basic contracts or their proposals. In six other awards we found that the Government estimates and the contractors' proposals were incompatible in that they were not in similar detail; thus, in our opinion, meaningful price analyses by comparisons of differences were precluded.

As discussed above and illustrated in the exhibit, the Corps and the NavFac have, in our opinion, placed unjustified reliance on

their cost estimates as a means of evaluating prices proposed by contractors.

Noncompliance with cost or pricing data requirements not reported in internal audit coverage

We were informed by Army Audit Agency (AAA) officials that, as part of the regular cyclic audits of Corps district offices, AAA had reviewed construction contracting practices for compliance with ASPR and other procurement regulations and had reported on deficiencies in Government estimating procedures and practices, negotiation proceedings, and documentation of procurement files. Our discussions with the officials and our review of AAA reports covering the period of our audit, however, disclosed no instances of reporting on noncompliance with the cost or pricing data requirements of Public Law 87-653 in the negotiation of construction contracts and modifications. To ensure coverage of this point in future reviews, AAA officials stated that specific mention will be made of this subject **in audit** guidelines for their district offices.

We noted that the Naval Audit Service program for the audit of procurement includes steps to (1) review the sufficiency of cost or pricing data furnished by contractors with their proposals, (2) evaluate the cost or price analysis performed, and (3) review other contract administration matters. Our discussion with Naval Audit Service personnel, however, disclosed no instances of reporting on noncompliance with the cost or pricing data requirements of Public Law 87-653 in the negotiation of construction contracts and modifications. We were advised that an audit program specifically designed for review of military construction was expected to be developed by June 1967.

## Conclusions

Our review of the award of negotiated construction contracts and modifications by the Corps and the NavFac showed a need to improve compliance with the requirements of Public Law 87-653. The Corps and the NavFac generally obtained price breakdowns and certificates of current cost or pricing data from the contractors and included the prescribed defective-pricing-data clauses in the contracts. The potential beneficial effect of these actions, however, was in our opinion largely negated because the Corps and the NavFac generally did not:

1. Require the contractors to identify, in writing, the bases or sources for significant elements in their proposed costs, when such identification was required by Public Law 87-653 and ASPR 3-807.3.
2. Perform cost analyses of the contractors' proposals, although required to do so by ASPR 3-807.2.
3. Request advisory audits, when such were called for by ASPR 3-809.

Our review indicated some doubt among Corps and NavFac personnel as to the applicability of the general procurement sections of ASPR to contracting for construction, especially the specific requirements of section III, entitled "Procurement by Negotiation," for compliance with Public Law 87-653.

In our opinion, there is no conflict between the requirements of this section and those of section XVIII relating to procurement of construction. However, ASPR 18-305.1 could be improved by emphasizing that the stated requirement applicable to procurements over \$10,000 to obtain, evaluate, and analyze contractor cost or pricing data where there are significant differences between the

Government estimate and the contractor's proposal (see p. 15) should not be construed to modify the requirements applicable to negotiated contracts and modifications over \$100,000 to obtain cost or pricing data and to make a cost analysis of such data as set forth in ASPR 3-807.2 and 3-807.3.

Although ASPR 18-305.1 makes reference to ASPR 3-807.3, it does not make reference to ASPR 3-807.2 which contains the requirement that a cost analysis be performed in connection with any negotiated contract or modification expected to exceed \$100,000 for which cost or pricing data are required to be submitted pursuant to ASPR 3-807.3.

The Corps' and the NavFac's negotiations of construction contracts were based primarily on comparisons of the contractors' proposals with Government cost estimates. We believe that the agencies placed unjustified reliance on the Government cost estimates as a means of evaluating prices proposed by contractors. In these circumstances and because of the lack of cost analyses or advisory audits, the Corps and NavFac, in our opinion, did not have adequate assurance that the contract amounts negotiated were fair and reasonable.

#### Agency comments

We brought our findings and conclusions to the attention of the Secretary of Defense and proposed that he emphasize to the Departments of the Army and Navy the need for improvement in the construction agencies' compliance with the requirements of Public Law 87-653 in the negotiation of construction contracts and modifications.

The Deputy Assistant Secretary of Defense (Procurement) in letters dated February 1 (see app. II), and March 9, 1967

(see app. III), commented on our findings and proposals pertaining respectively to the Corps of Engineers and the Naval Facilities Engineering Command. He agreed to the desirability of obtaining cost or pricing data, analyzing such data, and making increased use of advisory audits, when appropriate in accordance with ASPR 3-807.2.

The Deputy Assistant Secretary concurred in our suggestion that ASPR 18-305.1, "Preparation for Negotiation--Fixed-Price Type Contracts--Procurement of Construction and Contracting for Architect-Engineer Services," be more explicitly related to ASPR 3-807.2, "Requirement for Price or Cost Analysis." He stated that this relationship could be accomplished by changing the reference in ASPR 18-305.1(b) from "3-807.3" to "3-807.2" and that this change would be presented to the ASPR Subcommittee reviewing the need for further implementation of Public Law 87-653.

## SCOPE OF EXAMINATION

The Army during fiscal year 1966 awarded negotiated military construction contracts and modifications amounting to about \$320 million. We visited seven Corps of Engineers offices in the continental United States and several overseas offices and selected for review 55 construction contracts and 135 contract modifications having a negotiated value of about \$117 million, which had been awarded during the period November 1964 through March 1966.

The NavFac divisions during fiscal year 1966 awarded about \$87 million worth of negotiated military construction contracts and modifications. At the NavFac, we reviewed 12 construction contracts and 35 modifications having a negotiated value of about \$11.6 million, which had been awarded by seven division offices during the period November 1964 through June 1966.

In our review, we examined contracting officers' procurement files, particularly the contractor price proposals, the supporting data submitted by the contractors, the records of negotiations, and the Government estimates. We discussed the results of our examination with responsible local Corps and NavFac officials. We also visited several contractor locations and examined cost and pricing data relating to the price proposals reviewed, but we did not examine the records of actual costs incurred under the contracts. We did not include architect-engineer contract actions in our review,,

The following schedule summarizes the number and amounts of the contracts and modifications we examined at each office.

Summary of  
Contracts and Modiffcations Examined

Corps of Engineers offices	<u>Negotiated contracts</u>		<u>Negotiated modifications</u>		Number of actions	<u>Total amount</u>
	<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>		
Ballistic Missile Construction, Norton Air Force Base, Calif.	4	\$14,927,150	48	\$30,767,136	52	\$ 45,694,286
Canaveral, Merritt Island, Fla.	2	639,273	16	9,077,950	18	9,717,223
Fort Worth, Tex.	4	2,469,508	22	6,508,389	26	8,977,897
Kansas City, Mo.	2	1,712,011	-	-	2	1,712,011
Mobile, Ala.	-	-	21	13,560,999	21	13,560,999
New York, N.Y.	3	1,651,790	3	1,194,000	6	2,845,790
Omaha, Nebr.	-	-	3	646,577	3	646,577
Europe	18	12,150,690	2	389,410	20	12,540,100
Pacific	<u>22</u>	<u>14,249,512</u>	<u>20</u>	<u>6,973,804</u>	<u>42</u>	<u>21,223,316</u>
Total	<u>55</u>	<u>47,799,934</u>	<u>135</u>	<u>69,118,265</u>	<u>190</u>	<u>116,918,199</u>
<u>NavFac</u> <u>divisfons</u>						
Southeast, Charles- ton, S.C.	1	149,817	5	955,397	6	1,105,214
Midwest, Great Lakes, Ill.	1	201,243	-	-	1	201,263
Eastern, New York, N.Y.	-	-	1	142,880	1	142,880
East Central, Phil- adelphia, Pa.	2	250,000	1	262,900	3	512,900
Southwest, San Diego, Calif.	3	633,703	10	2,040,026	13	2,673,729
Pacific	4	943,595	18	5,854,350	22	6,797,945
Europe	<u>1</u>	<u>149,173</u>	<u>-</u>	<u>-</u>	<u>1</u>	<u>149,173</u>
Total	<u>12</u>	<u>2,327,551</u>	<u>35</u>	<u>9,255,553</u>	<u>47</u>	<u>11,583,104</u>
Grand total	<u>67</u>	<u>\$50,127,485</u>	<u>170</u>	<u>\$78,373,818</u>	<u>237</u>	<u>\$128,501,303</u>

F

PRINCIPAL OFFICIALS OF  
THE DEPARTMENT OF DEFENSE AND  
THE DEPARTMENTS OF THE ARMY AND NAVY  
RESPONSIBLE FOR ADMINISTRATION OF ACTIVITIES  
DISCUSSED IN THIS REPORT

	<u>Tenure of office</u>	
	<u>From</u>	<u>To</u>
<u>DEPARTMENT OF DEFENSE</u>		
SECRETARY OF DEFENSE:		
Robert S. McNamara	Jan, 1961	Present
ASSISTANT SECRETARY OF DEFENSE (INSTAL- LATIONS AND LOGISTICS):		
Paul R. Ignatius	Dec. 1964	Present
Thomas D. Morris	Jan. 1961	Dec. 1964
DEPUTY ASSISTANT SECRETARY OF DEFENSE (PROCUREMENT) :		
John M. Malloy	Apr. 1965	Present
Brig. Gen. Robert H. McCutcheon (acting)	Feb. 1965	Apr. 1965
Graeme C. Bannerman	Jan. 1961	Feb. 1965
<u>DEPARTMENT OF THE ARMY</u>		
SECRETARY OF THE ARMY:		
Stanley E. Resor	July 1965	Present
Stephen Ailes	Jan. 1964	<b>July 1965</b>
ASSISTANT SECRETARY OF THE ARMY (INSTAL- LATIONS AND LOGISTICS):		
Dr. Robert A. Erooks	Oct. 1965	Present
Daniel M. Luevano	July 1964	<b>Sept. 1965</b>

PRINCIPAL OFFICIALS OF  
THE DEPARTMENT OF DEFENSE AND  
THE DEPARTMENTS OF THE ARMY AND NAVY  
RESPONSIBLE FOR ADMINISTRATION OF ACTIVITIES  
DISCUSSED IN THIS REPORT (continued)

<u>Tenure of office</u>		
	<u>From</u>	<u>To</u>

DEPARTMENT OF THE ARMY (continued)

CHIEF OF ENGINEERS:

Lt. Gen. William F. Cassidy	July 1965	Present
Lt. Gen. W. K. Wilson, Jr.	May 1961	June 1965

DEPARTMENT OF THE NAVY

SECRETARY OF THE NAVY:

Paul H. Nitze	Nov. 1963	Present
---------------	-----------	---------

ASSISTANT SECRETARY OF THE NAVY (INSTALLATIONS AND LOGISTICS) :

Graeme C. Bannerman	Feb. 1965	Present
Kenneth E. BeLieu	Feb. 1961	Feb. 1965

CHIEF OF NAVAL MATERIAL:

Vice Adm, Ignatius J. Galantin	Mar, 1965	Present
Vice Adm. William A. Schoech	July 1963	Mar. 1965

COMMANDER, NAVAL FACILITIES ENGINEERING  
COMMAND (formerly Bureau of Yards and  
Docks) :

Rear Adm. A. C. Husband	Nov. 1965	Present
Rear Adm. Peter Corradi	Feb. 1962	Oct. 1965



OFFICE OF THE ASSISTANT SECRETARY OF DEFENSE  
WASHINGTON, D.C. 20301

INSTALLATIONS AND LOGISTICS

1 FEB 1967

Mr. James L. Di Guiseppi, Assistant Director  
Defense Division  
General Accounting Office  
Washington, D. C. 20548

Dear Mr. DiGuiseppi:

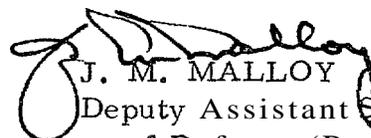
This is in response to your letter of November 28, 1966 forwarding a preliminary draft report to the Congress on compliance with Public Law 87-653 in the negotiation of construction contracts and contract modifications in the Department of the Army. (OSD Case #2538). The report states that a review of the contract files and records of negotiated contracts and change orders thereto at several District Engineer offices of the Corps of Engineers indicated that the cost or pricing data submitted by the contractors in support of price proposals were insufficient to meet the intent of Public Law 87-653 and the requirements of the Armed Services Procurement Regulation implementing this Public Law.

It is considered that the negotiation of contracts and modifications thereto by the Corps of Engineers have always been conducted with the objective of protecting the Government's interest. However, we are in agreement with the GAO report as to the desirability of obtaining cost or pricing data, need for analysis of such data, and making increased use of advisory audits, when appropriate in accordance with ASPR 3-807.2.

In this context, the Army will emphasize to the Chief of Engineers the requirements of ASPR 3-807.2 "Requirement for Price or Cost Analysis", ASPR 3-807.3 "Cost or Pricing Data", ASPR 3-809 "Contract Audit as a Pricing Aid" and ASPR 16-206 "Contract Pricing Proposal Forms".

We concur with your suggestion that ASPR 18-305.1 (Preparation for Negotiation - Fixed-Price Type Contracts - Procurement of Construction and Contracting for Architect-Engineer Services) be more explicitly related to the requirement of ASPR 3-807.2 "Requirement for Price or Cost Analysis". This can be accomplished by changing the reference in **ASPR** 18-305.1(b) from "3-807.3" to "3-807.2". This change will be presented to the ASPR Subcommittee reviewing the need for further implementation of PL 87-653 (ASPR Case 66-118).

Sincerely yours ,

  
J. M. MALLOY  
Deputy Assistant Secretary  
of Defense (Procurement)



OFFICE OF THE ASSISTANT SECRETARY OF DEFENSE  
WASHINGTON, D.C. 20301

ACQUISITIONS AND LOGISTICS

CA

9 MAR 1967

Mr. J. L. Di Guiseppe, Assistant Director  
Defense Division  
General Accounting Office  
Washington, D. C. 20548

Dear Mr. DiGuiseppe:

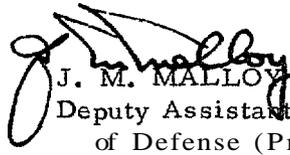
This is in reply to your letter of January 6, 1967 concerning compliance with Public Law 87-653 in the negotiation of military construction contracts awarded by the Navy Facilities Engineering Command (NFEC) (OSD Case #2538-S).

You allege from your review of 47 contract actions totalling approximately \$11.6 million awarded by offices of NFEC that contractors had either not submitted verifiable cost or pricing data or, when submitted the data was incomplete. You conclude that NFEC is not complying with PL 87-653 as implemented by ASPR in that adequate data was not obtained.

Your report contains no recommendations but references recommendations contained in an earlier draft report of November 28, 1966 relating to a review of construction contracts awarded by the Army Corps of Engineers. We responded to this earlier report by letter dated February 1, 1967. The substance of our comments at that time have equal application in this case. The Navy has stated that the requirements of ASPR 3-807, which implements PL 87-653, will be followed.

We have previously commented to your office of our concern regarding the ASPR implementation of PL 87-653. This matter is being thoroughly studied by a special ASPR Subcommittee under the direction of my office. We expect that the ASPR Committee will seek an opportunity to discuss proposed changes to the Regulation with representatives of the GAO after the Subcommittee's work has been reviewed.

Sincerely yours ,

  
J. M. MALLOY  
Deputy Assistant Secretary  
of Defense (Procurement)

**EXHIBIT**

EXAMPLES OF AWARDS NEGOTIATED  
WITHOUT OBTAINING AND ANALYZING  
SUFFICIENT COST OR PRICING DATA  
SUPPORTING CONTRACTORS' PROPOSALS

Army contract DA-25-066-ENG-13683,  
modification C

On September 7, 1965, the Corps of Engineers District Office, Omaha, Nebraska, awarded a negotiated modification for \$107,895 to an advertised contract for external auxiliary facilities for the North American Air Defense Command Combat Operations Center located in Cheyenne Mountain near Colorado Springs, Colorado. The modification provided for restoring external areas, which had been damaged by a cloudburst, to the conditions that existed at the time the contractor commenced performance under the original contract. Specifically, the contractor was required to remove rock, soil, and debris deposits and to do other work necessary to restore access roads A, B, and C; areas at the north and south portals; and the parking lot area.

Our review showed that, although the contractor certified that the pricing data furnished were accurate, complete, and current, the price proposal which it submitted to the contracting officer did not show any basis for its computations and was not supported in a manner permitting verification of the data certified. The entire proposal was as follows:

Emergency work:	
Subcontractor (named)	\$ 12,835
Direct labor	2,364
Direct equipment rental	5,753
Reshape ditches, bring in fill required on roads A and B	18,700
Clean all culverts	5,600
Make repairs to culverts	3,200
Remove and replace guard rail on road C	2,900
Repair east end of parking lot fill	1,300
Repair miscellaneous structures	2,900
Bring road C back to original condition, including south portal parking area	<u>46,600</u>
	102,152
Bond	680
Payroll tax	<u>2,036</u>
	104,868
Overhead and profit	<u>10,487</u>
Total	<u>\$115,355</u>

The area engineer had approved a detailed Government cost estimate which totaled \$108,555. The negotiations disclosed that the contractor contemplated in its estimate certain items of new work, such as a new concrete headwall and a new pipe culvert, which the Government had not intended to include in this modification. It was agreed that these and certain other items would be deleted and that the adjusted scope of work would be performed for \$107,895. This amount was considered fair and reasonable because it was less than the Government estimate.

Army contract DA-30-075-ENG-11982,  
modification 4

The Corps of Engineers District Office, New York, N.Y., negotiated a supplemental agreement for a research and development (R&D) facility addition and modification and an antenna reflector mount at Thule Air Base, Greenland. The reason given for not advertising these items was that early completion target dates established by the Air Force allowed insufficient time for taking bids, awarding a new contract, and mobilizing a new contractor at the remote site. Also, the incumbent contractor was already on the site working on the basic contract to rehabilitate and expand the facilities and was capable of performing the required additional **work**.

The amounts negotiated for the two modification items are shown below, together with a comparison between the contractor's proposal and the initial independent Government estimate.

<u>Item</u>	<u>Contractor's proposal</u>	<u>Initial Government estimate</u>	<u>Amounts negotiated</u>
R&D facility addition and modification	\$488,392	\$355,975	\$444,000
Antenna reflector mount and access	<u>20,333</u>	<u>18,307</u>	<u>18,000</u>
	<u>\$509,225</u>	<u>\$374,202</u>	<u>\$462,000</u>

The district office, in a letter dated June 21, 1965, requested the contractor to submit a complete proposal for the R&D facility addition and modification, accompanied by a breakdown of cost and a separate listing of profit. The breakdown was to be by trades; items of work affected; quantities and unit prices involved; and direct plant, labor, and material costs, including hours and hourly rates where applicable, together with applicable

percentages of labor costs for workmen's compensation, social security, and unemployment insurance. On July 17, 1955, the contractor submitted its proposal. This proposal, however, did not contain the information requested but was submitted only in the following summary form.

Materials	\$185,517
Labor	<u>142,497</u>
Insurance and taxes	<u>14,250</u>
Total direct costs	342,264
Indirect costs	<u>97,332</u>
Total direct and indirect costs	439,596
Profit	<u>43,960</u>
	483,556
Bond premium	<u>4,836</u>
Total	<u>\$488,392</u>

We asked a responsible district official why the district office had not insisted on a more detailed proposal. He replied that the district office had made it a practice to request detailed proposals but most contractors failed to submit them and that the district office took no further action to secure more detailed proposals prior to negotiation.

Contract negotiations were held at the district office on July 19 and 20, 1965. We were advised by the same district official that at this time the contractor furnished the Government negotiators with a copy of the work sheets which it had used in preparing its proposals and that these work sheets showed quantities of materials and related unit prices, estimated labor hours and

labor rates for various trades, and other pertinent pricing data. When we asked whether the contractor had also submitted vendor quotes supporting its material costs or other cost data in support of the work sheets, the official replied that he could not remember. A search of the files failed to disclose a copy of the contractor's **work** sheets or of any data in support thereof. The district office also had not requested an advisory audit of the contractor's proposal.

On the basis of the negotiations, the Government revised its estimate for the R&D facility from \$355,975 to \$444,433, or an increase of \$88,458.

Army contract DA-01-076-ENG (NASA) -2584 ,  
modification 3

A modification, providing for additional excavation and for material to replace unsuitable material encountered in a roadway construction at the National Aeronautics and Space Administration's Mississippi Test Facility, was negotiated by the Corps of Engineers District Office, Mobile, Alabama, on January 4, 1965, for \$373,784-- the exact amount of the contractor's proposal of December 3, 1964. The modification comprised the following items of work:

1. Clearing and grubbing--\$754.30.
2. Excavating--\$140,000 (estimated 100,000 cubic yards at \$1.40 a yard).
3. Borrowing--\$233,030 (estimated 100,000 cubic yards at \$2.3303 a yard).

Reimbursement was to be based on actual quantities of excavation under item 2 and of borrow under item 3 at the unit rates shown above. The excavation at \$1.40 a cubic yard was an increase in quantity at the same unit rate included in the basic advertised contract.

The borrow item was for the replacement of unsatisfactory material encountered in roadway construction, at a rate which had not been established in the basic contract. The Corps inspection report indicated that the contractor began work on this item on November 13, 1964, 1 day after the notice to proceed was issued.

In its proposal, the contractor estimated that moving the 100,000 cubic yards of borrow would take about 8 weeks with 13 trucks and drivers working 9 hours a day, 7 days a week. The contractor estimated that the 13 trucks **and** drivers could move 200 cubic yards of borrow an hour; therefore, it would take 500 hours

to move the borrow, or 6,500 trucking hours for the 13 trucks and drivers. Further, the contractor allowed \$13.35 an hour for trucking (truck and driver)--\$6 an hour for truck rental and \$5.56 an hour for direct labor, plus \$1.79 an hour for payroll taxes, insurances, contract labor penalty, and reporting.

The contractor stated in its certificate of current cost or pricing data that complete and accurate cost data current through December 9, 1964, had been considered in preparing the change order request and that these data had been submitted to the contracting officer.

Our review of the contractor's records applicable to the period November 18, 1964 (date on which borrow work was begun), to December 9, 1964 (date through which cost data was certified), revealed, however, that the contractor's actual cost for trucking (truck and driver) was \$10 an hour instead of the \$13.35 an hour shown in its proposal, or a difference of \$3.35 an hour. The contractor's actual cost was not disclosed in its proposal.

After we had raised questions on this award, the contractor, in a letter to the District Engineer on March 17, 1966, stated that the certified costs were those prevailing at the time and in the locality for rental trucks and truck drivers covering the period November 3 to December 29, 1964. Further, the contractor added that, at the time of certification and during the period in question, it had no assurance that this cost item could be reduced from the basis certified. The contractor pointed out that, as the operation was actually carried out, it assumed the risk of using owner-operated trucks and that the uncertainty, unreliability, and unpredictability of the owner-operators would not permit it to use the unit cost basis of this operation as a cost basis for estimate

and contract purposes. As noted above, however, the contractor, in its proposal, did not make full disclosure of its actual cost experience nor did it justify not using such costs, as the basis for its estimate of the trucking cost.

District personnel stated that the contractor's proposal had been accepted because it was substantially less than the Government estimate of \$404,160. We asked responsible agency officials why they had not obtained in writing from the contractor the type of cost or pricing data required by ASPR. The explanation we received was that cost or pricing data were not needed because the modification was negotiated on the basis of comparison of proposed prices with the Government estimate.

Navy contract NBy-67943,  
modification H

Under this advertised contract, a modification for a water-front facility was negotiated by the Southwest Division, NavFac, San Diego, California, in the amount of \$177,168, on June 27, 1966. The Government estimate of \$115,902 was prepared by an architect-engineer firm. The contractor, on May 2, 1966, proposed \$177,168 for this **work**.

The contractor's proposal was compared with the Government estimate. The Southwest Division's Board on Changes then adjusted the Government estimate upward about \$30,000 to add such items as subcontract costs, profit, and bond and insurance costs. The Board also noted that the Government estimate was prepared in December 1965 and did not include cost increases since that date. The Board concluded that the contractor's proposal was reasonable and compared favorably with current costs for similar work in the local area and on this basis approved the amendment for \$177,168--the amount of the contractor's Proposal.

As indicated above, in the total price negotiated, the \$31,000 which was in excess of the final Government estimate was apparently attributed by the Board to general cost increases between December 1965 and May 1966.

Navy contract NBy-65743

This contract for the installation of a telephone complex was negotiated on December 9, 1964, by the Southeast Division, NavFac, Charleston, South Carolina. The contractor submitted a detailed proposal in the amount of \$149,817, which covered 24 line-items, each showing estimated material quantities and prices and estimated labor costs. The Government estimate of \$152,018 was supported by a sketch of the area where the telephone cable was to be laid. The

sketch showed the linear feet required to lay the cable in three increments, each increment containing estimated costs for labor and material.

The elements of cost in the contractor's proposal could not be compared with those in the Government estimate. The NavFac considered the contractor's proposal reasonable on the basis of the total of the Government estimate and agreed to a price of \$149,817--the exact amount of the contractor's proposal.

Navy contract NBy-67358,  
modification A

Under this advertised contract, a modification for additional dredging, was negotiated on March 21, 1966, by the Southwest Division, NavFac, San Diego, California. The contractor verbally offered a price of 72.4 cents a cubic yard for a **total** of \$181,000 for 250,000 cubic yards. This unit price was the same as that in the **basic contract**, and, **according** to the contracting officer, **it** included mobilization costs which would not be incurred in the additional work.

The Contractor was not requested to submit any data in support of its proposal. NavFac negotiated a price of 68 cents a cubic yard, **or** a total price of \$170,000, without benefit of an independent Government estimate. The NavFac negotiation record stated that the negotiated price was determined to be reasonable on the basis of a favorable comparison with the basic contract price and with costs for similar work in the area.